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INFO RUEHBJ/AMEMBASSY BEIJING 8044
RUEHRL/AMEMBASSY BERLIN 1602
RUEHBY/AMEMBASSY CANBERRA 3056
RUEHLO/AMEMBASSY LONDON 2355
RUEHNE/AMEMBASSY NEW DELHI 8667
RUEHOT/AMEMBASSY OTTAWA 9774
RUEHFR/AMEMBASSY PARIS 6439
RUEHRO/AMEMBASSY ROME 2245
RUEHUL/AMEMBASSY SEOUL 4066
RUEHFK/AMCONSUL FUKUOKA 2746
RUEHNH/AMCONSUL NAHA 5094
RUEHOK/AMCONSUL OSAKA KOBE 6536
RUEHKS/AMCONSUL SAPPORO 3297
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C O N F I D E N T I A L SECTION 01 OF 07 TOKYO 000493

SIPDIS

STATE FOR EEB/IFD SAKAUE, WHITTINGTON, HUFF AND BROWN
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USTR FOR AUSTR CUTLER AND BEEMAN

E.O. 12958: DECL: 03/04/2019
TAGS: [ECON](#) [EFIN](#) [ETRD](#) [JA](#)
SUBJECT: JAPAN: REQUEST INFORMATION IN PREPARATION FOR G-20
MEETING

REF: STATE 17502

Classified By: CDA James P. Zumwalt, Reason 1.4 (b) and (d)

11. (C) Summary. Domestic political gridlock continues to stymie Japan's ability to implement the economic and financial policies needed to help lead the country out of its worst recession in over half a century. The government's economic stimulus measures have large headline figures, but the Cabinet Office estimates that the measures will only boost GDP by less than 1 percent. Prime Minister Aso promised bold action to correct plunging business activity, to ease fears of rising unemployment, and to address record drops in business confidence, but his policy proposals have neither slowed the speed of the drop in Japan's economic activity nor stemmed the erosion of his, his cabinets', or the ruling coalition parties' public support. Japan analysts are revising 2009 economic growth prospects downwards with most expecting a drop of at least 10 percent in the January-March 2009 quarter and forecasting that negative growth until at least the second half of 2009.

12. (SBU) Recent Mission reporting on the economic crisis and Japan's policy measures aimed at assisting the economy and workers is contained in the following cables, all of which have been e-mailed as well to State, Treasury, and NSC.

TOKYO 472
TOKYO 420
TOKYO 410
TOKYO 345
TOKYO 295
TOKYO 307
TOKYO 286
TOKYO 345
TOKYO 228
TOKYO 219

TOKYO 189
TOKYO 174
TOKYO 99
TOKYO 37
TOKYO 25
NAGOYA 1
08 TOKYO 3315
08 TOKYO 3430
08 TOKYO 3417
08 TOKYO 3408
08 TOKYO 3401
08 TOKYO 3326
08 TOKYO 3311
08 TOKYO 3302
08 TOKYO 3102
08 TOKYO 3079

MISSION JAPAN RESPONSES TO ECONOMIC CRISIS QUESTIONS

I. (SBU) Objectives for the London Summit

A. In the run up to the London Summit, what are the issues of greatest importance to the host government?

-- The GOJ is fixated on domestic political difficulties, with the ruling Liberal Democratic Party (LDP) primarily focused on the timing and outcome of Lower House elections that must take place by mid October 2009. Polls widely predict the LDP will lose to the opposition Democratic Party

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of Japan (DPJ), which now controls the Upper House. Aso has sought to leverage participation in international diplomacy, including in the G-20 Summit process, into an improved image at home to boost his and the LDP's election prospects.

B. Based on public comments made by host government officials, what are the country's likely objectives for the summit?

-- In his October 30 press conference before the first G-20 Summit in Washington, PM Aso named three priorities: (1) more effective international coordination on the supervision and regulation of financial institutions; (2) appropriate regulation of credit rating agencies; and (3) reform of international accounting standards, including easing requirements to mark-to-market.

-- The GOJ supports a rapid and significant capital increase for the Asian Development Bank. The GOJ also supports a generalized quota increase in the IMF and has offered to lend \$100 billion of its own reserves to the IMF. The IMF and MOF are working out the modalities of the loan.

C. Are there desired outcomes that officials have identified publicly?

-- Not beyond those listed above.

D. Based on public information, what recommendations or reforms might the host government suggest? For example, is the host government proposing changes to international financial architecture, reform of international financial institutions, or advocating the creation of new international bodies? Is the host government proposing additional regulation of financial products or institutions, making changes to existing regulatory standards, or advocating new best practices?

-- The only further specificity based on publicly available information came in October and November 2008, when the Accounting Standards Board of Japan: (1) issued a re-interpretation of the calculation of fair value for illiquid assets; and (2) allowed for the reclassification of some securities from the trading book. Both moves were

intended to be consistent with recent changes in U.S. Generally Accepted Accounting Principles (GAAP) and International Financial Reporting Standards (IFRS).

II. (SBU) Impacts of the Global Financial Crisis

1E. What are the host government's greatest financial market concerns (providing more liquidity to financial institutions, dealing with bad assets, injecting fresh capital, improving housing markets, guaranteeing deposits, making trade finance available, etc.)?

-- The GOJ's main financial market concerns have been:
(1) The effect of the fall in equity prices on bank capital, since Japanese banks still held JPY10.6 trillion in corporate equities at end-September book closings;
(2) The health of smaller regional banks, which were never cleaned up like the major banks in 1997-2004, and the consequent effect on lending to small and medium-sized enterprises (SME);
(3) The liquidity of the commercial paper (CP) market; and
(4) The ability of Japanese banks to access dollar funding.

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1F. What are the most important impacts on the host country's financial sector (what specific financial institutions have failed, which ones have had liquidity/solvency problems, has domestic lending to the corporate sector been affected, etc.)?

-- No major specific financial institutions have failed, though the three largest banks (Mitsubishi-UFJ Financial Group, Mizuho Financial Group, and Sumitomo Mitsui Financial Group) have moved to raise additional capital. One small life insurance firm, Yamato Life, failed in October 2008 after it made excessively risky investments, including in foreign structured securities, in an attempt to compensate for its relatively high distribution costs. Domestic lending to the corporate sector has actually increased since the CP market froze up, as firms moved from direct to indirect finance.

1G. What initiatives has the government taken in response to the financial crisis (has the government rescued financial institutions, provided capital injections or credit lines, changed its deposit insurance guarantees, provided interbank guarantees, established asset purchase programs, trade finance, etc.)?

-- The GOJ has budgeted JPY20 trillion to purchase corporate equities from the banks (although actual purchases will likely be much less). The objective is to remove a source of volatility from bank balance sheets without putting further downward pressure on the markets.

-- The Diet passed new legislation allowing the GOJ to inject up to JPY12 trillion in capital into banks. The GOJ has already started injecting capital into smaller, regional banks but has not announced any plans to inject capital into larger banks.

-- The Bank of Japan initiated a program to purchase outright up to JPY3 trillion in CP from financial institutions. The government-affiliated Development Bank of Japan (DBJ) will also purchase up to JPY2 trillion in CP directly from issuers.

-- The Bank of Japan also concluded a currency swap with the Federal Reserve Bank of New York for dollar funding (without an ex ante upper limit).

III. (SBU) The Broader Economic Crisis

1H. What are the most important impacts on the host country's real economy? What steps has the host government taken to mitigate the effects of the crisis?

-- Japan was already in recession when the crisis worsened in the fall of 2008. In Q4 2008, Japanese real GDP plummeted 12.7% quarter-on-quarter, seasonally adjusted. Real exports fell at an unprecedented 45% seasonally adjusted annual rate and net exports subtracted 11.5 percentage points from overall growth. A drop in domestic demand also subtracted 2.5 percentage points from overall growth, mostly due to declines in business investment (-19.5%) and private consumption (-1.6%). Inventory build-up contributed positive 1.4 percentage points to growth, which bodes poorly for Q1 2009. Non-GDP data releases for January are now becoming available and show continued drops exports and broader economic activity.

-- The GOJ has implemented three separate economic stimulus measures (one under former PM Fukuda and two under PM Aso).

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While their combined headline figure is an impressive JPY75 trillion, the Japanese Cabinet Office estimates that the actual effect on GDP due to the creation of new demand will be only 1%.

I. What has been the impact on trade, trade finance, and employment in export-oriented sectors? Are there problems financing exports and/or imports? If so, in which sectors? How is the host government attempting to address these problems?

-- Japan's exports (-45.7%) and imports (-31%) in January 2009 dropped dramatically according to GOJ data. Japan has run four consecutive month-on-month trade deficits and ran its largest current account deficit (Y968 billion) since current statistics began in 1980. Private analysts forecast Japan may run its first full-year trade deficit since 1980. Export-oriented companies (e.g., Toyota, Honda, Nissan, Panasonic, Sony, and shipping companies) are losing money, but they also are restructuring domestically and internationally to position themselves for when the global economy recovers. Restructuring includes cutting part-time, temporary, and contract workers as well as re-evaluating some planned expansions in plant and other investments. These companies are also applying for GOJ assistance programs, including emergency financing and financial support for overseas subsidies. Analysts' estimates of the number of "non-regular" workers who will lose their jobs between October 2008 and March 2009 run as high as 400,000. Media reports suggest Japanese multinationals have laid off over 50,000 workers at overseas production facilities.

J. How has the crisis affected the host government's outlook on trade and investment? Has there been a perceivable shift in how the government and population view the benefits of international trade? Are political pressures growing for protectionist policies? Are measures being taken or contemplated that would impose costs on other countries in an attempt to meet domestic needs (e.g., tariff hikes, import licensing or other trade restrictions on, or discrimination against, foreign investors)? Is the host government considering capital controls? On the other hand, is the host government considering easing investment restrictions in an effort to encourage foreign investment?

-- There has been no change in Japan's official policy of promoting inward FDI or the national goal of raising Japan's stock of FDI to 5% of GDP by FY2010. However, the need to address immediate issues of declining industrial production and increasing job losses means investment policy is not receiving the high-level political attention it has in recent years. Nonetheless, the bureaucracy continues to work on updating and implementing the national investment strategy. Japan is not considering capital controls. In fact, since the crisis began, Japan has experienced a capital inflow and a concurrent rise in the value of the yen. As part of its new draft investment strategy, the GOJ is considering changes to the effective corporate tax rate and targeted action plans

to promote inward FDI in selected industrial sectors, such as health care and medical devices.

-- Japanese media opinion pieces -- and public figures -- have questioned the soundness of the U.S. economic model and there have been articles comparing the Japanese "lost decade" to the current U.S. economic crisis. Government officials, however, have not expressed these sentiments and businesses are not abandoning their strategies for U.S. markets.

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Ministry of Foreign Affairs (MOFA) and Economy, Trade and Industry (METI) bureaucrats forcefully advocate for "no new protectionist measures" language in all leaders' declarations.

¶K. Do financial sector/industry bailouts or stimulus packages have local preferences? Is the government acting to influence the value of its currency (for example, to improve export competitiveness)?

-- The measures taken by the GOJ do not appear to have local preferences. There is foreign interest in participation in the new BOJ and DBJ initiatives to purchase CP. The GOJ has not intervened in the foreign exchange market since March ¶2004.

IV. (SBU) Near-term Outlook and Political/Foreign Policy Ramifications

¶L. How has the outlook for growth, inflation, the current account, exchange rates, and the budget deficit changed? What are the biggest economic challenges facing the host country in the coming months and year? How is this crisis expected to affect employment?

-- January 28 the IMF projected Japan's economy will contract 2.6% in 2009 before returning to positive 0.6% growth in ¶2010. However, since then, economic data have generally worsened. Private analysts project double digit negative growth on a seasonally adjusted annualized basis in Q1 2009. Private analysts also forecast a return to mild consumer price deflation in 2009. The general government budget deficit, already large, is projected to grow from 6.4% in FY08 to nearly 10% of GDP in FY2009. Given a debt-to-GDP ratio of 178%, Japan's lack of fiscal headspace inhibits the size of stimulus measures. Unemployment jumped up in December, although it ticked back 0.2 percentage points to 4.1% in January (seasonally adjusted), as discouraged workers left the labor force. The crisis has prompted political interest in providing greater protection for part-time and dispatch workers, who have borne the brunt of layoffs, even if those measures further restrict an already relatively inflexible labor market.

¶M. What are the potential political ramifications for the host country? How might the crisis directly impact leadership? Is a change of government a possibility? What are the social and security ramifications of the crisis?

-- Prime Minister Aso's public support numbers have fallen from the mid-40s in September to the low teens. Aso and the ruling LDP coalition's inability to undertake aggressive economic policies contributed to the drop in support, which could result in the first real switch between parties in power since the 1950s. A change in government is possible in the upcoming election, but given the present structure of the Japanese economy, only an increase in the U.S., Chinese, or other major foreign market demand for Japanese exports will result in the country's return to economic health.

¶N. Has the host government criticized and/or become significantly more critical of the United States for its role in the crisis or for provisions in the U.S. economic stimulus package (such as the "Buy American" provision)?

-- The GOJ has expressed concern on a number of occasions about "Buy American" provisions in the U.S. stimulus package

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and urged the U.S. and other countries to avoid implementing new protectionist in the name of combating the economic downturn. There is Japanese criticism of the U.S. as the cause of the crisis, but it has been muted and largely limited to select newspaper editorials. Instead, the government and high profile politicians have noted on many occasions that Japan's experience in the 1990s provides lessons for responding to the current crisis. These public figures also call for a coordinated regulatory and monetary responses within the G-20 and joint efforts to strengthen international financial institutions.

10. How might the crisis affect host government foreign or security policy and U.S. interests?

-- The global financial crisis hit Japan during a period of stagnating economic activity and severe domestic political turbulence, thereby heightening public dissatisfaction with PM Aso and threatening the half-century dominance of his ruling Liberal Democratic Party (LDP). With public support for his administration in the low teens and the Upper House of the Diet already in the hands of the opposition Democratic Party of Japan (DPJ), Aso is constrained in his ability to advance foreign policy and security goals. An electoral loss to the DPJ could result in a new direction for Japan's foreign policy and a period of uncertainty for U.S.-Japan relations. In the near term, however, the focus on domestic economic concerns should not have any real effect on the government's willingness or ability to meet its international commitments. If anything, Aso has worked hard to highlight continued cooperation with the U.S. and other international partners, as demonstrated by Japan's continued contribution to refueling efforts in support of Operation Enduring Freedom and the recent signing of an agreement to help finance the relocation of U.S. forces from Japan to Guam.

11P. How might the crisis affect the host government's ability and commitment to sustain foreign assistance levels?

-- Japan's leaders have signaled an intent to meet ODA commitments. In particular, the financial crisis has catalyzed efforts to use ODA to pave the way for private sector investment, particularly in Asia and Africa. At the World Economic Forum annual meeting in January, PM Aso said Japan is ready to provide ODA totaling JPY1.5 trillion (\$17 billion) to support regional development in Asia and he restated Japan's commitment to double assistance to Africa by 12012. Foreign Ministry officials are considering issuing a statement during the March 2009 Tokyo International Conference on African Development (TICAD) in Botswana calling on G-20 leaders to resist falling behind on ODA commitments to the region. In addition, a blue ribbon expert panel submitted a report to MOFA in February concluding the GOJ should restore the Japan International Cooperation Agency's facility to direct ODA to support private sector infrastructure projects. Japanese officials have reported no effect from the crisis on the GOJ's ability to fund official assistance, although the Japan Bank for International Cooperation is reportedly considering borrowing dollars from the GOJ's dollar reserves to offset increasing costs of raising dollars in the bond market to fund foreign lending.

11Q. How might the crisis impact government support for global peacekeeping operations and commitments to NATO operations, e.g., in Afghanistan?

-- Japan's tight fiscal situation has hit the Ministry of

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Defense (MOD) budget particularly hard. The 2008 defense

budget was the lowest in ten years as a percentage of GDP, despite a general trend towards expanded missions for the Self-Defense Forces. While government policy seeks expanded contributions to UN peacekeeping operations, MOD has resisted dispatching personnel to what the ministry considers "non-critical" missions such as Nepal and Sudan, in large part for existing budgetary reasons. The MOD has started to invest in equipment necessary to take part in larger scale multilateral operations, including Afghanistan. For example, in the JFY2009 budget, MOD procured a mobile field hospital and began the upgrade of its CH-47 heavy lift helicopter fleet (the second largest in the world) to support high-altitude operations.

-- Japan has made financial support for Afghanistan a priority despite government belt-tightening. In the FY09 budget, Japan allocated over \$300 million for support to the Afghan National Police, the NATO helicopter fund, and other stabilization projects in Afghanistan. Japan has also expressed interest in becoming a major contributor to the NATO Afghan National Army (ANA) expansion fund, although the GOJ seeks to earmark its money to ensure it is spent only on non-lethal programs. Japan has made a number of additional commitments as the 2009 G-8 Chair to support international peacekeeping and peacebuilding initiatives. Funding for existing programs, such as the \$15.5 million support for PKO centers in Africa and Asia through the Japan-UNDP Partnership Fund, is already locked in and should not be affected by the economic crisis.

ZUMWALT